Quarterly Market Commentary as at 30 June 2009*

Market Indices	Returns as at 30 June 2009						
	1 mth (%)	3 mth (%)	6 mth (%)	1 yr (%)	3 yr (% p.a.)	5 yr (% p.a.)	10 yr (% p.a.)
Australian Shares							
S&P/ASX 200 Accum	4.00	11.29	9.08	-20.14	-3.82	6.86	7.17
International Shares							
MSCI World Ex Aust (AUD) Net	-1.62	3.56	-8.79	-16.24	-10.76	-3.14	-2.99
Australian Fixed Interest							
UBSA Composite Bond Index 0+ Yr	-0.61	-1.33	-1.05	10.82	6.36	6.05	6.20
International Fixed Interest							
Citigroup World Govt Bond 100% Hdg (AUD)	0.99	0.21	0.52	11.48	8.43	7.70	7.61
Property							
S&P/ASX 200 A-REIT	4.60	15.17	-12.90	-42.27	-22.66	-8.40	2.19
Cash							
UBSA Bank Bill Index	0.27	0.79	1.75	5.48	6.41	6.13	5.72
Currency							
Australian Dollar ($A/$US)	1.00	16.36	15.96	-15.76	2.86	3.02	0.96

Australian Shares

The Australian sharemarket rose over the June quarter, with the S&P/ASX 200 Accumulation Index up 11.3%. Over 12 months the sharemarket was down 20.1%.

Improving global financial conditions, a number of 'green shoots' in the global economy and a resilient Australian economy saw the Australian sharemarket perform well over the quarter. Some key policy outcomes from the G20 meeting in early April and the results of the stress tests of the US banking system also buoyed the market over the quarter and added to the generally more buoyant mood.

Australia's economic growth figures (as measured by gross domestic product, GDP) were released. Economic growth was better than expected at +0.4% for the March quarter 2009 (versus -0.6% for the December quarter 2008). This took the annual pace of growth to 0.4%. A strong contribution from net exports and a positive contribution from consumption led to the better than expected result.

The Federal government released its 2009/2010 budget, forecasting a $A58bn deficit. The good news is the government cash handouts delivered over the quarter assisted the economy, with retail sales rising sharply. As a result, the Consumer Discretionary sector was the best performing sector over the quarter, rising 17.9%. David Jones (+62.5%), Flight Centre (+62.3%) and JB Hi-Fi (+33.7%) all rose strongly.

Over the quarter, listed companies continued to recapitalise through raising additional equity capital. With debt funding constrained, companies have turned to the sharemarket with over $A80bn of issuance over the 2008/09 financial year. Over the quarter, large capital raisings included Asciano Group, ANZ Banking Group, Macquarie Group, Adelaide Brighton, Alumina, Aristocrat Leisure and OneSteel. Most top listed companies have now recapitalised and this should help sharemarkets continue to move forward.

Among the top 20 companies, top performers included Macquarie Group (+46.0%), Brambles (+24.2%) and Wesfarmers (+20.2%). Over the quarter the short selling ban on Financial companies was lifted. The bottom performers were Newcrest Mining (-6.8%), Origin Energy (-1.1%) and CSL (-1.1%).

The recent sharemarket rally had much to do with the potential for an economic recovery. While it is positive that the market has rallied off its low, there are still several impediments to a sustainable economic recovery. Financial market conditions need to continue to stabilise, the US housing sector must recover and there are concerns that rising bond yields and rising oil prices may limit the ability of the global economy to recover. On the upside, despite the recent rally, valuations still look reasonable, but an improvement in business conditions and profits will be required for further sustainable gains in the sharemarket.

International Shares

International sharemarkets were strong over the June quarter. Global sharemarkets rose as the unprecedented policy response gained traction and there was an improvement in the US banking system.

The MSCI World ex Australia Net Index rose 20.5% in $US and was up 3.6% when measured in Australian dollars in the quarter. Over 12 months, the index was down 16.2% in $A terms. During the quarter, the Australian dollar rose sharply from US 69.27 cents to US 80.75 cents.

Some concrete policy outcomes of the G20 assisted the global sharemarket rally. An increased financial commitment and a plan to restore credit, growth and jobs buoyed market when announced. Also assisting the sharemarket rally was the results of the stress tests of US banks.

Over the quarter, the Dow Jones Industrial index rose 11.0%, the S&P 500 was up 15.2% and the NASDAQ index rose 20.1%%. Over 12 months the Dow Jones Industrial index is down 25.6%. Signs of weakness in the US economy remain, with the unemployment rate standing at 9.5% at the end of June 2009, up from a low of 4.4% in October 2006.

Markets in Europe were also positive as the European Central Bank cut interest rates further and introduced a form of credit easing. Despite this, the European economic recovery is expected to be some time off. Sharemarkets in Spain (+27.6%), Italy (+23.5%), Germany (+17.7%) and France (+15.7%) all rose in the June quarter. Over 12 months, all sharemarkets remain in negative territory, with Italy (-32.6%) the weakest performer. In the UK, the FTSE 100 index rose 8.2% over the quarter. UK GDP fell 2.4% over the June quarter 2009, the largest drop since 1958.

Asian markets fared well over the quarter. Japan's Nikkei index rose 22.8%, but remains down 26.1% over 12 months. The Japanese economy continues to be weighed down by weak demand for its exports. Singapore (+37.2%) and Hong Kong (+35.4%) both rose sharply, while China rose a more muted 18.2% despite ongoing signs of economic growth.

The global economy appears to have stabilised. While this is positive, it is important to remember it has stabilised at a low level. For a sustained recovery to take place the financial system needs to continue to improve and the US housing market needs to repair. Recent rises in bond yields and oil prices could limit the extent of the recovery in the global economy although this must be tempered across the large policy stimulus already introduced.

Australian Fixed Interest

In Australia, the release of the Federal government's Budget made headlines. The 2009/10 Budget is expected to produce a deficit of almost $A58bn, or 4.9% of gross domestic product (GDP). The Budget is expected to remain in deficit until 2015/16, with the government needing to issue significant levels of Commonwealth bonds. This will take the total on issue from around $A80bn at end of June 2009 to just on $A300bn by June 2013. While these debt levels are large for Australia, they compare favourably internationally. Australia's net debt to GDP ratio is expected to peak at around 14% in 2014, compared to average levels in other advanced economies of over 80%.

Ten year Australian government bond yields began the quarter at 4.42% and ended it at 5.52%, well up from the low of 3.85% in mid January 2009. Rising bond yields internationally were driven by some better economic data. The return on the UBSA All Maturities Composite Bond index in the June quarter was -1.33% as bonds sold off. Over the 12 months to 30 June 2009 the return on the index was 10.82%.

As we look into the remainder of 2009, yields will be affected by the pace of economic recovery out of the US and Australia, the growth in the supply of bonds and the outlook for inflation.

International Fixed Interest

Globally, fixed interest markets appeared more settled over the quarter. There was an increase in issuance of government bonds, but to date these have generally been met with firm demand by the market. Credit spreads narrowed and bond yields rose, although they traded with some degree of volatility.

Internationally, the focus moved from central bank action to government debt issues as a number of countries released their Budgets over the quarter. The highlights are the rising issuance of government debt over the coming years and the consequent implications for longer term bond yields.

With the UK and the US issuing large amounts of government bonds, when combined with rising optimism of a global economy recovery, bond yields rose sharply over the quarter. This follows a fall in bond yields in the March quarter as quantitative easing was introduced in the UK and US.

Over the quarter, US 10-year bond yields rose from 2.66% to 3.53%. They reached a high of 3.94% in early June, with markets factoring in a quick US economic recovery and expectations that the Federal Reserve will consider lifting official interest rates. Late in the quarter, bond yields fell as a dose of reality hit markets with some weaker economic data released. Official interest rates stand at a target of between 0% and 0.25% in the US, 0.10% in Japan, 0.50% in the UK and 1.00% in Europe. The European Central Bank cut interest rates by 25 basis points in May.

Australian Property (including Listed and Direct)

The Australian REIT sector rose 15.2% in the June quarter to be down 42.3% over 12 months. Of the 17 stocks in the index, only one fell over the quarter. The Mercers Direct Property Index fell 6.2% over the June quarter, to be down 12.4% over 12 months.

Over the past 12 months, the listed sector has undertaken significant capital raisings and changes to distribution policies as a means of dealing with excess levels of debt. While the high yield currently available on the sector is proving attractive to investors, this needs to be tempered against expectations of weakening income growth as the demand and supply balance continues to deteriorate.

Over the quarter, Dexus Property Group, GPT Group, Stockland, Mirvac Group and ING Office Fund all raised capital.

The industrial sector was the best performing sub-sector over the quarter, up 23.4%. The diversified (+18.8%), retail (+14.4%) and office (+8.0%) sub-sectors all rose.

The better performers over the quarter were Macquarie CountryWide Trust (+139.6%), ING Industrial Fund (+96.0%) and Charter Hall Group (+94.5%). Commonwealth Property Office Fund (-3.7%), CFS Retail Property Trust (+5.1%) and Dexus Property Group (+9.9%) were more muted.

Cash

The UBS Australia Bank Bill index returned 0.79% in the quarter and 5.48% over the past 12 months. Ninety day bank bills rose slightly over the quarter, beginning the quarter at 3.14% and ending it at 3.19%. The average yield during the quarter was 3.16%, compared with 7.80% a year earlier.

The Reserve Bank of Australia (RBA) reduced its official cash rate from 3.25% to 3.00% over the quarter, with a 25 basis points cut in April. Rates were on hold in May and June as the global economy stabilised, confidence improved, the Chinese economy recovered and the Australian economy proved resilient.

After being much of the focus for 2008, new inflation figures released in Australia over April indicated the risk of inflation was diminishing. A weaker outlook for inflation has assisted the substantial interest rate cuts by the Reserve Bank of Australia (RBA) and the ability of interest rates to stay lower for longer.

Currency

The Australian dollar ($A) rose 16.4% against the US dollar ($US) during the quarter. It began the period at US 69.27 cents and ended it at US 80.75 cents. The $A appreciated sharply in May with rising investor optimism and demand for commodities. Much of this optimism was centred on the pace and timing of a global economic recovery.

In the June quarter the $A rose 1.3% against the UK pound as the Bank of England lifted its quantitative easing program. The $A rose 2.6% against the New Zealand dollar; and was up 13.0% against the Japanese yen and 2.6% against the euro as the outlook for the economic recovery in Australia looks brighter than Japan and Europe.

At the end of June 2009 the $A was buying 1.2501 New Zealand dollars, 77.78 yen, 0.4905 UK pence and 0.5748 euro cents.

***Source:** This commentary has been prepared by Colonial First State Investments Limited ABN 98 002 348 352 AFSL 232468 and is general information only.